(4)

No. 85-568

In the Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY, ET AL., PETITIONERS

v.

STATE OF NORTH CAROLINA, ET AL.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

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QUESTIONS PRESENTED

Under the Federal Power Act, the Federal Energy Regulatory Commission has sole authority over transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce. The questions presented are:

1. Whether the North Carolina Utilities Commission acted in contravention of the Supremacy Clause in failing to give effect in calculating the retail rates for local end-users in North Carolina to the costs and allocations contained in the federally regulated interstate wholesale transactions that preceded the final retail sale.

2. Whether the North Carolina Utilities Commission rate order at issue in this case is also invalid under the Commerce Clause because of the economic preferences it grants local consumers at the expense of interstate markets.

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INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Article I, Section 8, Clause 3 of the United States Constitution provides that "[t]he Congress shall have Power * * * [t]o regulate Commerce * * * among the several States"; pursuant to that authority, Congress has charged the Federal Energy Regulatory Commission with the responsibility for administering the Federal Power Act, 16 U.S.C. 791a *et seq.*, including those provisions governing rates and charges for electric energy at wholesale in interstate commerce. 16 U.S.C. 824d, 824e. The North Carolina decision challenged in this case significantly intrudes upon the Commission's area of statutory responsibility by adopting a retail rate structure that departs substantially from the terms recognized by the Commission for wholesale transactions. Subordinating the federal determinations to those of the State undermines the uniform regulatory system contemplated by Congress.

STATEMENT

A. *Background: The Relevant Agreements.* Nantahala Power and Light Company, an electric utility serving the public in North Carolina, is owned by Aluminum Company of America (Alcoa). Alcoa also owns Tapoco Inc., which serves exclusively Alcoa's aluminum operations in eastern Tennessee. Both companies own hydroelectric facilities along the Little Tennessee River, built many years ago with Alcoa financing and licensed by the Commission under Part I of the Federal Power Act.[1]

In the midst of these facilities is the large Fontana hydroelectric plant, built by the Tennessee Valley Authority (TVA) in the early 1940s. From the construction of Fontana until after the events relevant to this case, with very minor exceptions TVA directed the operation of all these facilities.[2] During the relevant time period, these arrangements for TVA control were governed by the New Fontana Agreement (NFA), signed in 1962, among TVA and Nantahala-Tapoco-Alcoa. That agreement provided that TVA would direct Nantahala's and Tapoco's operations of their hydroelectric plants and take all the energy generated from them, which would vary according to stream flow conditions. In return, certain specific entitlements to energy and power were to be supplied to Nantahala and Tapoco-Alcoa by TVA. The NFA itself, however, did not detail how much of these entitlements would go to each; these matters were spelled out in separate agreements. For puposes of this case, the relevant document is the 1971 Apportionment Agreement between Nantahala and Tapoco.

Both Nantahala and Alcoa bought power from TVA to meet their needs beyond what they received as entitlements

[1] See 16 U.S.C. 797(e).

[2] This permitted TVA to coordinate them for the most efficient total operation.

from TVA under the NFA, as provided for in the 1971 Apportionment Agreement.[3] However, this power purchased from TVA was relatively expensive—it cost about three times as much as entitlement power. Thus, the entitlement power received under the NFA, with costs based on the cost of running the Nantahala and Tapoco generating units, was less than 6 miles per kilowatt hour (kwh); the cost of power purchased from TVA with its higher expenses averaged about 19½ mils per kwh.[4]

B. *The Decision Of The Commission.* In 1982, the Commission issued two orders in *Nantahala Power & Light Co.*, 19 F.E.R.C. ¶ 61,152, aff'd in part and reh'g denied in part, 20 F.E.R.C. ¶ 61,430. See J.S. App. 283a-301a, 302a-313a. These orders arose out of a rate increase filed by Nantahala and a complaint proceeding filed by certain of its customers. Following appeals by Nantahala, by some of its customers and by the Attorney General of North Carolina, the court of appeals affirmed the Commission's decision in all respects. *Nantahala Power & Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

In the proceedings before it, the Commission had examined the NFA and the 1971 Apportionment Agreement, which were filed with it as rate schedules. The Commission held that the NFA was "the result of arms' length bargaining" and that it "indicates no intent on the part of any of the parties to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates." 19 F.E.R.C. at 61,278. The Commission did decide, however, that adjustments were required in the 1971 Apportionment Agreement to give a somewhat

[3] Alcoa, unlike Nantahala's customers, made its own power purchasing arrangements directly with TVA.

[4] Nantahala's and Tapoco's generation is all old, low cost hydropower; TVA, as hydro sources were exhausted, has more recently had to add considerable capacity from more costly, non-hydro sources, and to distribute these costs to its customers.

bigger share of the entitlements from TVA to Nantahala, and decided how much that greater share would be. *Id.* at 61,279-61,280.

Based on that readjustment, the Commission established the rates that Nantahala could collect from its three wholesale customers in North Carolina: Once the Commission established the division of entitlements, it followed that the remaining volumes of power required would be purchased from TVA under the contractually established rates. Rates to Nantahala's wholesale customers thus reflect the respective costs of its entitlements and its purchased power.

C. *The Ruling Of The North Carolina Commission And The State Supreme Court.* The North Carolina Utilities Commission (NCUC), in its review of retail rates, in effect rejected the NFA on the basis that it was unfair to Nantahala and did not result in just and reasonable rates (J.S. App. 15a, 32a, 70a-71a).[5] It substituted an approach proposed by Nantahala's customers,[6] which would give Nantahala, and consequently the North Carolina customers, a larger share of the low cost entitlements, and correspondingly reduce their need for expensive purchases.

Specifically, the NCUC first calculated the available capacity and energy, which it defined to include the capacity of and energy available from both the Nantahala *and* Tapoco facilities (J.S. App. 68a-69a). This reflected the figures available to TVA, rather than the smaller volumes of entitlements which Nantahala and Tapoco received from TVA for delivery to their customers.

[5] The NCUC decisions are unreported and appear at J.S. App. 165a-235a, 236a-247a. The opinion of the North Carolina Court of Appeals (J.S. App. 141a-164a) is reported at 65 N.C. App. 198, 309 S.E.2d 473 (1983), and the opinion of the North Carolina Supreme Court (J.S. App. 1a-138a) is reported at 313 N.C. 614, 332 S.E.2d 397 (1985).

[6] The FERC had earlier rejected that approach. See *Nantahala*, 727 F.2d at 1347-1349.

The NCUC then added to this calculation the amount of power and energy Nantahala bought from TVA and delivered to its customers; it did not include Alcoa's TVA purchases (J.S. App. 68a-69a). This amount defined the NCUC's "pool" of power. The NCUC next calculated how much power Nantahala needed to serve its customers. At that time, it amounted to about 25% of the pool (J.S. App. 68a-69a). The NCUC then totalled the costs associated with generating power from both the Nantahala and Tapoco facilities and the cost of Nantahala's purchased power (but not Alcoa's). It applied the 25% figure to that amount to derive what Nantahala would be allowed to collect from its North Carolina retail ratepayers.

This method of calculation resulted in a shift of low cost power to the Nantahala load compared with what the Commission had determined in its proceeding. As the NCUC said, it gave Nantahala "first call" on the electric energy output deemed available (J.S. App. 183a). Unlike Nantahala's customers, Alcoa (Tapoco's customer) would not get an allocation based on its needs. It was left only with whatever residual low cost power remained after both Nantahala and TVA had taken their supplies of "available" power. At the same time, Alcoa was made responsible for all the residual costs after what the NCUC assigned Nantahala (J.S. App. 69a-70a). Alcoa thus was required to assume the costs not only of all of its own TVA purchases, but 75% of Nantahala's as well. Alcoa's share of the costs was further swollen by that attributable to the power that went to TVA and was not reflected in entitlements received in return.

The North Carolina Supreme Court recognized that there were substantial questions under the United States Constitution concerning preemption and interference with interstate commerce (J.S. App. 12a-13a). It concluded, however, that there was no constitutional infirmity and affirmed the NCUC in all relevant aspects (J.S. App. 12a, 72a-106a).

DISCUSSION

This case presents an important question concerning the scope of permissible state authority within the federal regulatory scheme established by the Federal Power Act. The Federal Energy Regulating Commission has made determinations pursuant to its unquestioned authority over wholesale transactions concerning how "entitlements" to certain power, received in return for other power, should be divided between two utilities, serving neighboring states. Those determinations have been reviewed and affirmed by the United States Court of Appeals for the Fourth Circuit. Despite this exercise of federal authority, North Carolina, on the ground that it was carrying out its retail ratemaking responsibilities, declined to give effect to—and indeed adopted a rate structure sharply at odds with—the supply arrangements adopted by the Commission.

The result is that the state authority substituted its judgment for that of the Commission and gave its own citizens a bigger share of the low cost power, leaving less for the neighboring state's customer. In so doing, the North Carolina Utilities Commission has seriously undermined the Commission's jurisdiction under the Federal Power Act, and has done violence to fundamental Commerce Clause principles. The NCUC is intruding on the Commission's area of responsibility, acting in disregard of Commerce Clause principles and strong precedent established by decisions of this Court. In these circumstances, plenary review is warranted.

A.

1. Electric power moves freely across state lines, via a vast interstate transmission grid, and, as a result, "production and transmission of electricity is an activity particularly likely to affect more than one State." *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 377 (1983). Accordingly, "maintaining the proper balance between state and federal authority * * * has long been a serious challenge to both judicial and congressional wisdom." *Ibid.* Under the Federal Power Act, the Commission is given complete authority over wholesale activity (bulk power arrangements between utilities) while the states regulate retail activity (with the ultimate consumer). 16 U.S.C. 824. This jurisdictional line, however, is not as bright as might appear on first impression, since by their nature, wholesale rates at some subsequent point are embedded in retail costs.

Disputes over the scope of federal versus state regulation have been arising with increasing frequency as interutility arrangements grow in number. A considerable body of case law has developed at the state court level, holding that states are prohibited from re-evaluating the wholesale rates and disallowing those deemed unreasonable as costs for retail ratemaking purposes.[7] The NCUC decision in this case is fundamentally inconsistent with that case law.[8]

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[7] See, *e.g.*, *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), cert., denied, 435 U.S. 972 (1978); *Northern States Power Co.* v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn. 1984), cert. denied, No. 83-1752 (June 18, 1984); *Eastern Edison Co.* v. *Department of Public Utilities*, 388 Mass. 292, 446 N.E.2d 684 (1983); *Washington Gas Light Co.* v. *Public Service Commission*, 452 A.2d 375 (D.C. 1982), cert. denied, 462 U.S. 1107 (1983); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981); *United Gas Corp.* v. *Mississippi Public Service Commission*, 240 Miss. 405, 127 So. 2d 404 (1961); *City of Chicago* v. *Illinois Commerce Commission*, 13 Ill. 2d 607, 150 N.E.2d 776 (1958).

[8] While the principle now seems well-established in the case law, nonetheless these cases are still continuing to arise today. Appellants have cited in of their juridictional statement (at 20 n.29), for example, a number of very recent decisions involving the Middle South Utilities and American Electric Power complexes of companies.

2. This court has yet to address the matter directly. However, it has long been established that under the Federal Power Act, the federal government has preempted the entire wholesale area. See, *e.g.*, *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 340 (1982); *Maryland* v. *Louisiana*, 451 U.S. 725, 750-751 (1981); *Arkansas Electric Cooperative*, 461 U.S. at 381.[9] Not only does the federal scheme leave no room for direct state regulation of wholesale prices, it leaves no room either for state regulations that indirectly yield the same result. *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84, 91 (1963).

It is also well established that a rate filed with the Commission and subject to its jurisdiction cannot be challenged in another forum; only the Commission is empowered to order it changed. *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-252 (1951) ("We hold that the right to a reasonable rate is the right to the rate which the Commission files or fixes, and that, except for review of the Commission's orders, the court[] can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one."). Under governing preemption doctrine, the filed rate is reasonable as a matter of law and any effort by a state to disregard or reject it is impermissible. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 581-582 (1981). While the North Carolina Supreme Court pays lip service to this settled rule, it has effectively asserted the authority to disregard the Commission's filed rate. The state court recognizes that the Commission has exclusive jurisdiction over the wholesale power transactions and agreements between and among Nantahala,

[9] The Supremacy Clause establishes that "[t]his Constitution, and the laws of the United States which shall be made in Pursuance thereof * * * shall be the supreme Law of the Land * * * any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. Art. VI, Cl. 2.

Tapoco, Alcoa and TVA (J.S. App. 12a), but nonetheless proceeds substantially to revamp that structure more to its own liking. This the Supremacy Clause prohibits. *Arkansas Electric Cooperative*, 461 U.S. at 389; *Fidelity Federal Saving & Loan Association* v. *de la Cuesta*, 458 U.S. 141, 153 (1982).

3. At the core of this case rests a classic dispute concerning the allocation of the inexpensive entitlement power, and the costs associated with it, between customers in different states. A state of course has a legitimate interest in reducing the cost to its citizens of electric power, but its authority to effectuate that reduction is not unbounded; there are constitutional limitations inherent in our federal structure that must be obeyed. In this case, there is a finite amount of the cheap power, and a pool of costs that must be absorbed by someone. The approach employed by the NCUC would benefit the Nantahala customers by giving them more of the low cost entitlement power, and permitting them to absorb less of the costs associated with that power. However, it would have the concomitant result of forcing additional costs on the other customer, the one located in Tennessee.

Under the Federal Power Act, Congress has established a federal regulatory authority to deal with what have long been properly viewed as matters of inherently interstate concern, the bulk power arrangements between utilities so important in the electric utility business today. The Commission is empowered to make or review these arrangements. It is inconsistent with the scheme Congress has established to permit state authorities to change these arrangements to make them more favorable to their own citizens at the expense of operations in other states.[10]

[10] It is clear that is what the State has done here. At an earlier stage of this case, the North Carolina Supreme Court remanded the case to the NCUC to determine whether the approach Nantahala's customers were proposing "would be in the best interests of the customers of Nantahala." *State ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980).

The system Congress established explicitly provides states and state commissions with a significant role within the federal regulatory framework. The states may file complaints about inter-utility activities (16 U.S.C. 825e), and these complaints may ultimately result in Commission action declaring rates, practices and contracts unjust and unreasonable and establishing new ones (16 U.S.C. 824e(a), 824d(e)). The states may also seek review of Commission orders in the federal courts (16 U.S.C. 825*l*(b)). What the states are precluded from doing, however, is acting inconsistently with Commission determinations with which they are dissatisfied. By effectively invalidating federally filed arrangements, the state is indirectly dictating the wholesale price, in derogation of the Commission's responsibility. To permit that dictation is flatly inconsistent with the federal regulatory framework established by Congress.

B.

1. Even if, contrary to our submission, the Federal Power Act leaves room for some state regulation affecting commission regulated transactions, the state may not, as a constitutional matter, enforce "protectionist regulation that the Commerce Clause declares off-limits to the states." *New England Power Co.*, 455 U.S. at 339. See also *City of Philadelphia* v. *New Jersey*, 437 U.S. 617, 623-624 (1978).[11] "Economic protectionism" may be found on the basis of either discriminatory purpose or discriminatory effect. *Bacchus Imports, Ltd.* v. *Dias*, No. 82-1565 (June 29, 1984), slip op. 6; *City of Philadelphia* v. *New Jersey*, 437 U.S. at 626. The cost shifting reflected in the NCUC's

[11] "[T]he [Commerce] Clause has long been recognized as a self-executing limitation on the power of the States to enact laws imposing substantial burdens on [interstate] commerce." *South-Central Timber Development Inc.* v. *Wunnicke*, No. 82-1608 (May 22, 1984), slip op. 5.

"first call" approach, designed to further the "best interests" of North Carolina customers (note 10, *supra*), is suspect on both grounds (see pages 4-5, *supra*).

2. There is an alternative standard for determining the extent of permissible state action in the absence of any federal action: even-handed regulation with only incidental effects on interstate commerce. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *City of Philadelphia* v. *New Jersey*, 437 U.S. at 624; *Hughes* v. *Oklahoma*, 441 U.S. 322, 331 (1979); *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 36 (1980). Formidable difficulties in the interstate utility context, however, may make this a less than fully satisfactory standard for the Court to apply in this case.

On the one hand, when it comes to distributing something between two states, any decision by one state to benefit its people necessarily will place an offsetting burden on interstate commerce; the relationship is such that this burden is properly characterized as direct, rather than merely incidental. On the other hand, as the First Circuit observed in *Massachusetts* v. *United States*, 729 F.2d 886, 888 (1984):

> [when allocating costs of power between customers in two states] [n]either law nor economics can identify one unique set of rates or practices as "reasonable," *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251 71 S.Ct. 692, 695, 95 L.Ed. 912 (1951), and each state would prefer a rate structure that benefitted its residents to the detriment of its neighbors.

The net result of permitting each state to enact its own reasonable regulation may nevertheless be an unacceptable overall system.[12]

[12] For example, where the ratemaking question at issue is whether or not to consolidate the operational costs of companies serving different states, sometimes a reasonable argument can be made for or

For this reason, neither the Commerce Clause nor the prohibition against confiscation in the Fourteenth Amendment[13] provide fully satisfactory guidelines for resolving conflicting state interests. This is, at least in part, because ratemaking is inherently a legislative function. *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 589 (1945). See also *FPC* v. *Texaco Inc.*, 417 U.S. 380, 389 (1974). The Commission, which has independent statutory power to set rates, is better equipped than the Court to undertake this function.

3. There is a well established distinction in the electric power area between what is "essentially local" and what is "essentially national" and thus beyond the reach of state authority. *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83, 90 (1927); *Arkansas Electric Cooperative Corp.*, 461 U.S. at 390. This case involves a matter that falls squarely into the "essentially national" category, involving competing state interests that inherently call for the exercise of impartial federal authority.[14] The effect of the NCUC's decision to ignore the Commission's allocation for the purpose of setting retail rates, reflects

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against such a consolidation. Rates are tied to costs, and so a state with companies that have above average costs would probably opt for consolidation, while its neighbor, with companies that have below average costs, would not. While each individual state decision to favor its own consumers in establishing rates would be reasonable, the net result would be that the revenue to plants operating in the two-state area would be inadequate to cover their costs.

[13] See, *e.g.*, *Missouri ex rel Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U.S. 276, 289 (1923); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[14] Cf. *South-Central Timber Development, Inc.* v. *Wunnicke*, slip op. 9-10. The need to resolve such competing state interests is the fundamental justification for the Commerce Clause. See *Hughes* v. *Oklahoma*, 441 U.S. 322, 325, 326 (1979); *Bacchus Imports, Ltd.* v. *Dias*, slip op. 7-10; *H.P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 533-534 (1949).

the same sort of direct burden on interstate commerce that the Eighth Circuit recently found unconstitutional on Commerce Clause grounds in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission*, No. 84-2409 (8th Cir. Aug. 23, 1985), slip op. 22-23.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

CHARLES FRIED
Solicitor General

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission

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